

Amy Rabinowitz, Counsel
Massachusetts Electric Company
25 Research Drive
Westborough, MA 01582-0099

RE: Massachusetts Electric Company and Nantucket Electric Company,
D.T.E. 99-84 (Compliance Filing)

Dear Ms. Rabinowitz:

On June 29, 2001, the Department of Telecommunications and Energy (ADepartment@) orderreddirected Massachusetts Electric Company and Nantucket Electric Company (collectively, AMECo@ or ACompany@) to file a service quality (ASQ@) plan that compliesd with the guidelines established by the Department. Service Quality Standards for Electric Distribution Companies and Local Gas Distribution Companies, D.T.E. 99-84, at 40 (2001). On October 29, 2001, MECo filed an Offer of Settlement (AOffer@) that was jointly sponsored by the Company, the Associated Industries of Massachusetts, the Attorney General, the Division of Energy Resources, and The Energy Consortium (collectively, the ASettling Parties@). The Offer revised MECo=s current SQ plan that has been in effect as a result of the Department=s approval, in Massachusetts Electric Company/Eastern Edison Company, D.T.E. 99-47 (2000), of MECo=s rate plan settlement (ARate Settlement@) relating to the merger of Eastern Edison Company into MECo.

OnBy letter dated October 31, 2001, the Department informed the Company that the Offer did not apply the Guidelines as set forth in D.T.E. 99-84, and therefore was incomplete. The Department directed that MECo supplement its filing with an SQ plan that applied the Guidelines. (October 31st Letter at 1). Accompanied by a letter dated November 2, 2001, MECo made this supplemental filing on November 2, 2001 (ASupplemental Filing@). In the filing letter dated November 2, 2001 at 3 (ANovember 2nd Letter@), MECo stated that the implementation of the SQ Plan Awould represent an Exogenous Factor@ under its Rate Settlement, and Aif necessary would propose a quantification of the Exogenous Factor adjustment.@ On November 7, 2001, the Settling Parties filed a letter supporting the Offer.

MECo and the Settling Parties contend that the Department should approve the Offer rather than the Supplemental Filing (November 2nd Letter at 2; November 7th Letter at 1).

MECo and the Settling Parties state that MECo implemented an SQ plan in 1999 as part of a long-term rate stabilization plan (November 2nd Letter at 1; November 7th Letter at 2). MECo states it has been operating the business with the current plan in mind, making both short- and long-term decisions to try to improve service quality in the key performance measures under the plan (November 2nd Letter at 2).[@] MECo and the Settling Parties argue that MECo should be allowed to simply revise its SQ plan, which would then maintain the rate stabilization elements of MECo's rate plan approved in D.T.E. 99-47, while still conforming to the broad terms of the Guidelines (October 29th Letter at 2-4; November 7th Letter at 3).

ThisThe current proceeding, D.T.E. 99-84, was opened by a Notice of Inquiry to address an initiative on SQ standards undertaken by the Department and adopted by the Legislature in G.L. c. 164, ' 1E. This proceeding employed a non-adjudicatory process that has been used in proceedings such as Mergers and Acquisitions, D.P.U. 93-167-A (1994), Incentive Regulation, D.P.U. 94-158 (1995), Interruptible Transportation/Capacity, D.P.U. 93-141-A (1996), and Terms and Conditions, D.T.E. 97-65 (1997). There is neither statutory authority nor precedent specifically authorizing the Department to approve settlements in this type of proceeding. See G.L. c. 30A, ' 10 (authorizing the Department to approve settlements in adjudicatory proceedings). The Offer will be considered, therefore, not so much as a resolution of a dispute under G.L. c. 30A, ' 10, but rather on its usefulness and conformity with G.L. c. 164, ' 1E and our SQ Order of June 29th.

In support of its authority to offer a settlement in this proceeding, MECo relies on language from its Rate Settlement, approved in D.T.E. 99-47, which states:

[T]he signatories agree that Mass. Electric's Service Quality Plan shall be subject to modification if a generic performance based program is authorized or required by the Department. Accordingly, Mass. Electric shall implement revised performance standards to closely align with any generic performance based program that may be authorized or required by the Department during the Rate Period. Mass. Electric will consult with the parties prior to filing any such revision to this Plan and the parties agree that they will work together to develop a proposal before the Department. If the revised standards would result in a significant difference in the balance of risks, costs and benefits set forth in [Mass. Electric's Service Quality Plan], the quantified differences shall be recognized as an Exogenous Factor

(October 29th Letter at 2-3 citing Rate Plan Settlement at 26-27.)

This provision, however, does not require the Department to accept an offer of settlement from MECo and the Settling Parties. In fact, this paragraph (1) describes MECo's responsibilities to the other parties in D.T.E. 99-47 regarding the subsequent changes to

MECo's service quality plan that would be required by D.T.E. 99-84, (2) acknowledges that MECo must implement revised performance standards that closely align with those developed in D.T.E. 99-84, and (3) seeks to afford MECo the opportunity to seek recovery of any significant cost increases resulting from the implementation of any revisions to its quality plan as an Exogenous Factor.¹

Whether or not MECo has been operating its business with the current plan in mind, the Department clearly noted that MECo's current SQ plan was subject to wholesale replacement when we approved MECo's Rate Settlement in D.T.E. 99-47, at 31. The Department specifically stated:

Even before the Rate Plan Settlement was filed, the Department had already opened a generic proceeding docketed as D.T.E. 99-84, on service quality standards for electric distribution companies and natural gas local distribution companies. Dependent upon the outcome of D.T.E. 99-84, the Petitioners concede, the instant service quality plan is subject to modification. Therefore, the Department approves the service quality plan proposed by the Petitioners with the condition or caveat that the Department's Order in D.T.E. 99-84 may lead to wholesale replacement, or to significant modification of some or all of the components of, the Petitioners' plan. These changes might include, but are not limited to, changes in penalties, incentives, benchmarks, benchmarking method, monetary thresholds before penalties (or incentives) are collected from a company (or redound to it), and methods of distributing penalties or collecting

¹ In the Offer, MECo waives any claim for exogenous cost recovery due to implementation of the revised service quality plan. The Settling Parties imply that this waiver is an additional benefit to customers (November 7th Letter at 3). In contrast, in the filing letter dated November 2, 2001 at 3, MECo stated that the implementation of the SQ Plan would represent an Exogenous Factor under its Rate Settlement, and if necessary would propose a quantification of the Exogenous Factor adjustment. The provision for exogenous cost recovery, however, is not automatic. The issue of what constitutes a significant change in MECo's perceived risks in relation to the costs associated with meeting service quality requirements is a factual matter requiring a determination by the Department, based on the evidentiary record that would be presented at the time that MECo seeks self-executing; MECo's request for any exogenous cost recovery must be squarely presented before the Department for review so that it can be determined, after appropriate analysis, whether the cost recovery presented by the Company can actually be considered exogenous, and, if so, whether the Department should allow recovery. MECo's claim, though suggested on the record, is not squarely before us. Whether it will be depends on the disposition of the Offer.

incentives. Thus, the proposed service quality plan could be completely replaced, dependent upon the outcome of our generic service quality investigation.

Id. at 31-32. MECo went on with its merger under this explicit notice in the Order approving the merger.

Furthermore, concerns of consistency in this proceeding may militate against approval of an offer of settlement that diverges from the Guidelines. The Department opened this matter in October 29, 1999. We solicited numerous rounds of comments and issued an interim order with proposed guidelines on August 17, 2000. D.T.E. 99-84 (Interim Order) at Att. A. We received several more rounds of comments before issuing our Order containing the final Guidelines on June 29, 2001 and subsequently, an Order on Motion for Clarification on September 28, 2001. Throughout this lengthy participatory process, our goal was explicit: to develop guidelines or standards to be applied to all utilities. The rationale for developing uniform guidelines rather than company-specific plans was simple. It promotes administrative efficiency and allows the Department to evaluate each company's performance in comparison with other utilities.

Of course, we recognized that a particular company may have a legitimate reason for departing from our Guidelines. To this end, companies also were directed to provide full support for any deviations in their proposed SQ plans from our Guidelines. D.T.E. 99-84, at 42. Here, however, the Company has not yet offered sufficient justification for the significant deviations from the Guidelines in their Offer.

MECo and the Settling Parties assert that the Offer complies with the Guidelines in principle. MECo and the Settling Parties refer to the similarity of the performances measures and their weighting with those contained in the Guidelines. While the Offer does establish performance requirements and penalty features, they are not the same as provided in the Guidelines. In fact, similarities in these areas between the Offer and the Guidelines are outweighed by their differences, which are discussed below. Furthermore, the Offer does not contain any of the Guidelines' reporting requirements, which act as an early warning system regarding SQ and provide information that may be used for future SQ plans.

In addition, the Department also questions whether the Offer provides the SQ benefits to customers that MECo and the Settling Parties claim. While MECo and the Settling Parties argue that the Offer will maintain rate stability, return money to customers when poor performance occurs, and apply more stringent service quality standards to MECo, our review of the Offer does not support these conclusions.

First, MECo and the Settling Parties claim the Offer is an element of, and is integral to, the rate stabilization provisions of the Rate Settlement that the Department approved in D.T.E. 99-

47. The rate stabilization provisions of the Rate Settlement, however, are the five-year distribution rate cap and the subsequent five-year distribution rate index. These provisions are not in, nor are they related to, the MECo's current SQ plan, which accrues penalties or rewards on an annual basis based upon a comparison of MECo's actual performance with its historical performance in a number of performance categories. In D.T.E. 99-47, at 31-32, the Department made clear the separateness of these provisions by emphasizing that the service quality plan was subject to modification based on the results of our investigation in D.T.E. 99-84. We approved the SQ plan with the condition or caveat that the Department's Order in D.T.E. 99-84 may lead to wholesale replacement, or to significant modification of some or all components These changes might include, but are not limited to, changes in penalties, incentives, . . . monetary thresholds before penalties (or incentives) are collected from a company (or redound to it), and methods of distributing penalties or collecting incentives.[@] Id. Therefore, the Department may replace MECo's SQ plan, and any such replacement will not affect the rate stabilization provisions.

Second, MECo and the Settling Parties argue that the Department should approve the Offer because MECo will return money to customers if performance does not meet benchmarked levels (October 29th Letter at 4, 6-10). The Offer, however, continues the penalty provision of the SQ plan provisionally accepted as part of the Rate Settlement, in that net penalties and incentives are carried forward from year to year until a balance of \$20 million is reached, after which only amounts in excess of the \$20 million are refunded or collected.² Therefore, unless the accumulated penalties exceed \$20 million, substandard performance in any given year would result in no negative revenue consequences to MECo.³ The Department has stated that the purpose of SQ penalties is to provide an impetus for distribution companies to conduct themselves in such a way that there is no need to impose monetary penalties in the first place. D.T.E. 99-84, at 29 n.27. Because revenue penalties must be of sufficient magnitude to affect a utility's behavior, any revenue penalties must be paid once a company's service quality

² The Offer provides that any balance remaining as of December 31, 2009, whether positive or negative, would be credited or charged to ratepayers over a one-year period commencing January 1, 2011.

³ The Company has booked transmission and distribution revenues of \$650,142,559 for the 12-month period from October 1, 2000 through September 30, 2001 (November 2nd Letter, Att. 3, at 1). According to the SQ penalty formula, two percent of these revenues, or \$13,002,851, is the maximum penalty that the Company could incur under the Offer. Therefore, MECo could be subject to the maximum penalty for all of the performance measures and still not be subject to revenue consequences, as MECo would not exceed the \$20 million threshold. This situation could result in SQ deterioration without MECo suffering revenue consequences.

performance falls below the specified levels in any given year. The Offer's \$20 million threshold permits the Company to avoid, or at the very least defer, the revenue consequences of its failures to provide acceptable service. The penalty, if any, would not be imposed proximate in time to the triggering non-compliance.

Third, MECo and the Settling Parties cite MECo's customer service guarantee program as another reason why the Offer should be approved (October 29th Letter at 7). MECo proposes that any payment it makes under the Offer's customer service guarantee program would not be deducted from its maximum revenue penalty level as provided in the SQ Plan. MECo argues this feature distinguishes its program from that required by the Guidelines. The Offer's \$20 million threshold, however, which we have discussed above, effectively reduces the advantage this feature may have over the Guidelines.

Finally, MECo and the other Settling Parties rely on two other provisions of the Offer as reasons why the Department should approve its revised service quality plan. MECo and the Settling Parties state that the inclusion of a standard for distribution line losses is a benefit to customers (October 29th Letter at 5). MECo itself, however, has acknowledged problems with using this performance category as a SQ measure. D.T.E. 99-84, at 15, citing MECo Comments at 12. MECo has stated that measuring electric distribution line loss is difficult. Id. Based on these comments and similar comments from the Joint Utilities, the Department acknowledged that it was difficult for an electric distribution company to reliably assess line losses at present time.⁴ Id. at 18. Therefore, the Department declined to adopt a SQ measure

⁴ The Department stated that an electric distribution company may experience percentage variations in line losses from year to year unrelated to SQ degradation. D.T.E. 99-84, at 18. In fact, the Department acknowledged that much of the annual variation in line

for line loss.⁵ Id. For the reasons stated in D.T.E. 99-84, we do not yet see inclusion of line loss as a benefit to ratepayers.

MECo and the Settling Parties also state that the provision in the Offer to adjust the historical benchmarks with updated information on all SQ measures is a benefit to MECo's customers (October 29th Letter at 5; November 7th Letter at 4). MECo states that the historical

losses stems from the effects of electrical load on a system. Id. Furthermore, the Department stated that the amount of load on a system is not entirely within the control of electric distribution companies. Id.

⁵ Nevertheless, the Department stated that Aline losses have a real impact on costs to ratepayers. Electricity lost through distribution line loss is not metered, and therefore, the cost of this electricity is borne by all ratepayers.@ D.T.E. 99-84, at 18. Therefore, to monitor line losses by companies and to enable the Department to propose a measure for line losses in the future, the Department directed the electric distribution companies to report annual line loss data, using company-specific methods. Id.

benchmark is updated each year but that the standard that triggers the maximum penalty is never lowered (October 29th Letter at 5). The Settling Parties, however, state the historical benchmark is updated annually to reflect new data, subject to a floor equal to the initial minimum level of service standards (November 7th Letter at 4). The Settling Parties are incorrect. While the maximum penalty level remains the same through the term of the Offer, there is no floor to the historic benchmark (Response to D.T.E. 1-1, 1-2). Therefore, pursuant to the Offer, a decline in SQ makes it less likely that the minimum penalty will be incurred but more likely that the maximum will be. This is not necessarily a benefit to customers.

In sum, the Department has doubts about MECo's and the Settling Parties' assessment of the Offer. The Department finds that the Offer is not similar in substance or in principle to the Guidelines and does not necessarily provide added benefits to MECo's customers. Therefore, for all the reasons stated in this letter, the Department does not accept the Offer at this time. MECo and the Settling Parties may, however, file such additional support for their Offer in D.T.E. 01-71B as they see appropriate, and we will further consider the Offer.

The Department, however, must still assess MECo's Supplemental Filing.⁶ Upon review, the Department finds that while the Supplemental Filing applies the Guidelines, there are some SQ measures and reporting requirements that are either not in strict compliance with the Guidelines or not consistent with the intent of the Guidelines. Therefore, the Department directs MECo to make the following changes to its Supplemental Filing, within three business days of the issuance of this Order, in a new filing:

1. File separate plans for MECo and Nantucket Electric Company. See New England Electric System/Nantucket Electric, D.P.U. 95-67 at 2 (1995).
2. Restore original sentence language in ' I.A: ~~Al~~n the event of a conflict between these guidelines and any orders or regulations of the Department, said orders and regulations shall govern.~~@~~
3. Restore original definition of ~~AElectric Distribution Feeder@~~ in ' I.B.
4. Omit language in ' I.B. defining MECo's operating area as ~~Aa geographical subdivision@~~ and include language defining MECo's operating area to be its franchise territory.
5. Omit language specifying years SAIDI and SAIFI data will be collected in ' I.C.

⁶ MECo submitted the Supplemental Filing on November 2, 2001 pursuant to the Department's request on October 31, 2001.

6. Omit language stating MECo will endeavor to provide call-handling times for Emergency Calls in ' II.A.
7. Omit language in ' II.B stating MECo will collect data for service appointments effective January 1, 2002.
8. Omit language in ' III.B allowing MECo to adjust historical results regarding billing adjustments for inflation.
9. Omit language in ' V.J allowing MECo to identify any interruption initiated by Company for the purpose of public and employee safety as a planned interruption.
10. Omit MECo's language in ' VI regarding staffing levels and insert the following:
AStaffing levels will be in accordance with the Guidelines and reviewed when the company files its annual performance data.@
11. Clarify the Guidelines at ' VII.A to read: APenalty offsets may only be used to offset revenue penalties in the year they occur.@
12. Clarify the penalty formula in the Guidelines at ' VII.B to include the payments under the customer service guarantee program.
13. Clarify the Guidelines at ' VII.B to read:

$$\text{Penalty}_M = \left[0.25 * \frac{(\text{Observed Result} - \text{Historical Average Result})^2}{\text{Standard Deviation}} \right] * \text{Maximum Penalty}$$

If: (Observed Result - Historical Average Result) represents performance that is more than one standard deviation worse [better] than the benchmark and is capped at two standard deviations from the benchmark.

14. Clarify ' VIII.B to specify five years data for SAIDI and SAIFI.
15. Omit in '' VIII.H, VIII.I, and X procedure for outage and accident reporting and apply only the outage and accident reporting protocol set forth in the Department letter dated August 24, 2000 letter.
16. Restore '' XI and XII regarding billing information and Department's discretionary powers.

Furthermore, the Department directs MECo to update its performance data as necessary to include all actual performance data from May 1, 2000, up to and including October 31, 2001.

In Investigation into the Quality of Electric Service, D.T.E. 01-71, the Department is reviewing application of SQ plans filed pursuant to D.T.E. 99-84. At the conclusion of that proceeding, the Department may determine that modification of SQ plans is appropriate (see D.T.E. 01-71A Town of Brookline public hearing, Tr. at 57, ln. 7-13 (Nov. 26, 2001)). Therefore, as we have stated in our Order regarding NSTAR Electric's SQ plans, the Department's approval of MECo's Supplemental Filing will be subject to modification; and it

may be that MECo and the Settling parties will mount a more persuasive case than has heretofore been made for their Offer.

In reviewing MECo's filings, the Department, however, distinguishes between regulatory requirements and managerial objectives. The Department is mindful of MECo's managerial goals and related judgments concerning particular initiatives that may be seen as appropriate for system-wide implementation. Such judgments reside with management and no intrusion on the proper sphere of management functions prerogatives is contemplated by the Department. This view is consistent with general utility law. Holyoke Street Railway v. Department of Public Utilities, 347 Mass. 440, 446 (1964); New England Telephone & Telegraph Company v. Department of Public Utilities, 262 Mass. 137, 146-151 (1928). Accordingly, if managerial objectives make it appropriate for MECo to produce a single SQ plan for distribution to employees, MECo may do so and submit such an umbrella plan for informational purposes, in addition to the approved individual compliance filings that the Department will use to measure the quality of electric service provided by MECo and Nantucket Electric Company. In keeping with the individual compliance approach set forth in this Order, the Department reiterates that penalty offsets and credits may not be carried forward by the individual companies from the year for which they are calculated to a late performance year; nor may credits be transferred from one company to another in any year. Each company will be judged on its own performance for each performance year.

By Order of the Department,

James Connelly, Chairman

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Eugene J. Sullivan, Jr., Commissioner

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MECo Compliance Filing

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Deirdre K. Manning, Commissioner

cc: D.T.E. 99-84 Service List